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SUBJECT: UK HOUSING MARKET SHOWS SIGNS OF RECOVERY BUT LONG-TERM
OUTLOOK REMAINS UNCERTAIN

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¶1. (SBU) Summary: UK housing prices showed a slight increase in June and July, and mortgage lending was also up. Despite these signs of recovery, the market outlook remains uncertain. Market prices are still down, year-on-year, 6.2 percent over the past 12 months as reported by Nationwide Building Society, and 15 percent as reported by Halifax, the UK's largest mortgage lender. Nationwide reported July house prices are 14.6 percent lower than their peak in late 2007; Halifax said June housing prices are down 21 percent from the peak in August 2007. Concerns remain about the limited mortgage lending being offered and the effects of rising unemployment. UK government actions to help home owners facing repossession, first-time home buyers and the mortgage industry seem to have had limited success so far. While many believe the UK has seen the worst of the slump, a sustained housing market recovery remains far off. End summary.

Housing Indicators

¶2. (U) House prices have fluctuated so far this year, with the largest UK lenders reporting sometimes conflicting price trends throughout the first six months of 2009. In July, Nationwide reported a 1.3 percent rise in the average home price to GBP 158,871, marking the third consecutive month of increases. The group announced a cumulative 1.3 percent increase in prices since the start of 2009. In June, however, Halifax registered a 0.5 percent decrease in prices from the previous month. (Note: Halifax price index is seasonally adjusted while the Nationwide index is unadjusted.) Property website Rightmove reported a 0.4 percent month-on-month price fall in June, but a 0.6 percent rise in July. Additionally, this group reported that asking prices are up by 6.7 percent from the start of 2009. For the first time since January 2008, the house price index from Land Registry increased in June. The index showed a 0.1 percent rise in the price of an average home in England and Wales, with the rate of annual decline narrowing to 14 percent.

¶3. (U) New home construction is down dramatically, falling 44 percent in the second quarter from last year's levels. There were 18,340 seasonally adjusted housing starts in England in the quarter, a 13 percent increase from the last quarter of 2008, but still well below levels from 2008. Annual housing start figures have consistently declined over the past few years, falling 51 percent last year from peak levels in 2005-2006. Despite recent downward revisions in projected repossessions and arrears for 2009 by the Council of Mortgage Lenders (CML), the numbers are still expected to increase. The CML reported 17,049 repossessions in the three months to June, and predicted that 2009 might see a total of 65,000 repossessions. This 2009 prediction was revised down from 75,000

after a range of government programs were introduced to help those threatened by repossession. Mortgage arrears are increasing more markedly than repossessions and the CML estimated that 3.24 percent, or 360,000, of all mortgages will be in arrears of at least 2.5 percent of their outstanding debt in 2009. This is 15 percent less than previously predicted, but double the amount of homeowners in arrears at the end of 2008. Lower mortgage rates allow greater capacity for banks to work with borrowers with variable rate mortgages who are facing arrears and more homeowners seem to be making contact with their lenders to find mortgage help. Rightmove predicted that unemployment driven repossessions and arrears are likely to drag on into 2010 and 2011.

Are Banks Being Tight-fisted or Is There Limited Demand?
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¶4. (U) While overall lending volumes remain weak, there have been a few steady signs of improvement in the mortgage market over the past few months, with the Council of Mortgage Lenders (CML) and the Bank of England both reporting lending increases and encouraging trends in the credit market in June. The CML reported a 17 percent increase in gross mortgage lending from GBP 10.5 billion in May to GBP 12.3 billion in June, which was still, however, 48 percent lower than June 2008 levels. The group forecast gross mortgage lending of GBP 145 billion this year and revised upward its forecast for net mortgage lending in 2009 from a GBP 25 billion contraction to a smaller GBP 5 billion contraction from 2008 levels. Official data for May from the Bank of England reported lending is at its lowest level since records began in April 1993, but also showed a slight rise in the flow of net mortgage lending and mortgage approvals from major UK lenders in June.

¶5. (U) Many banking industry groups claim that the mortgage lending levels have remained low because of the lack of quality in demand. Paul Samter of the CML agrees, saying limited consumer demand continues to dampen recovery. In its Trends in Lending report, even

the Bank of England acknowledged that there is subdued demand for mortgages and weak re-financing activity, and that both will persist for some time. Industry groups have also contended that uncertainty about capital and liquidity requirements have constrained their lending.

Government Efforts - Effectiveness Remains To Be Seen
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¶6. (U) Recognizing that the lack of mortgage financing dampened prospects for recovery in the housing market, HMG, during the past six months, implemented several measures to stimulate the market and encourage banks to increase lending. The Asset-Backed Guarantee Scheme (ABS), announced in January 2009 and made available in April, is a government backed guarantee on triple-A rated asset-backed securities, including mortgages. Critics of the scheme argue, however, that restrictions on whom can take part in the plan and the loans offered are bringing limited success. The Communities and Local Government Select Committee of Parliament called it "impressive, but doomed to fail." As of July 14, none of the major banks had issued a security with an ABS guarantee.

¶7. (U) HMG also targeted efforts on potential home buyers and home owners, especially those who were in jeopardy of losing their homes. HMG's Home-Buy-Direct is a shared-equity scheme aimed to combat the limited number of mortgages available to qualified first-time home buyers. Under the program, the government purchases up to 30 percent equity in the house, without a fee for the first five years of ownership. In return, the government receives a share of any capital gain realized when the house is sold. So far though, the program has been relatively ineffective as banks remain hesitant to lend to first-time buyers. The Homeowner Mortgage Support scheme was introduced in April 2009 to help homeowners experiencing financial difficulties in the economic crisis, but it has yet to see a significant take off. The plan allows borrowers to defer a portion of their mortgage interest payments for up to two years if they are experiencing a temporary, unexpected drop in income. Several large banks, including Lloyds Banking Group, part of

Halifax, and Royal Bank of Scotland, have agreed to participate in the scheme, but the program has seen a slow start and critics question its effectiveness. A deal under the scheme can take three to five months to process; UK authorities expect, however, more completed deals over the coming months.

¶8. (U) The Mortgage Rescue Scheme, announced in January 2009, is a GBP 285 million package of measures designed to prevent vulnerable families losing their homes. The scheme, aimed at those who would be eligible for homelessness assistance, either provides an equity loan to homeowners, reducing the size of their mortgage, or purchases the home and rents it back to the former homeowner at an affordable rate. The government owns some equity in the house as part of this plan, and participants are able to buy-back the equity of their home when they can afford to. The UK's Department for Communities and Local Government said the scheme aimed to help 6,000 families, but as of the beginning of July, only six households had used it to avoid repossession. The scheme has been criticized for the length of its eligibility process.

¶9. (U) The UK government also extended a stamp-duty (tax on property purchases) exemption to relieve household tax burdens until the end of 2009; the House of Commons' Communities and Local Government Committee recommended in a report that the government not renew the measure after 2009. The plan gives a one year stamp-duty holiday to homeowners whose properties cost less than GBP 175,000. While Halifax reported in May that the exemption has helped around 45,500 buyers in England and Wales, the plan's impact on the overall affordability of homes is marginal. The government is also concerned about the limited numbers of new home construction. The dramatic decline in housing starts - 44 percent in the second quarter of 2009 in comparison with the second quarter of 2008 - prompted the UKFs housing minister, John Healey, to announce a GBP 1 billion investment program July 27 to kick-start house-building projects that stalled during the recession. While the initiative remains in the planning stages, funding given to construction companies could create around 22,000 new homes in the UK.

Signs of an End to the Worst, But Uncertainty Remains
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¶10. (U) Commentators and industry players remain doubtful about the direction of the housing market. The Council of Mortgage Lenders forecasted that gross mortgage lending will be GBP 145 billion for the year, but the group was cautious to release any significant future forecasts citing considerable uncertainty about a range of factors affecting the strength of the mortgage market. The Bank of

England predicted mortgage lending may continue to strengthen in coming months and Rightmove predicted a subdued "steady state" for the market with a slight 7 percent increase in house prices for the year. No group expects any dramatic improvements over the coming months but many believe the market has passed its worst point. Others remain more pessimistic. Housing charity Shelter predicted repossessions could rise to between 100,000 and 125,000 in 2011, up from 65,000 in 2009. The Council of Mortgage Lenders expects there will be about 425,000 borrowers at least three months behind with their home loan payments by the end of this year. PricewaterhouseCoopers predicted the housing market will stay in the "doldrums" until the middle of next year and prices will fall a further 5-10 percent for the next 18 months before beginning to pick up.

¶11. (U) Another real concern is the effect of rising unemployment on the housing market. Unemployment is expected to reach 3 million in the UK by the end of the year, which could add to mortgage payment arrears and to the number of repossessions will continue to increase, though at a slower rate. Job uncertainty will also discourage first-time home buyers from the entering the housing market.

¶12. (SBU) Comment: It would be premature to predict that the UK housing market is on its way to a strong recovery. Housing prices may have bottomed-out; however, the recent rallies could be temporary, especially now that the spring buying season has ended.

The UK housing market slump from 1989 to 1996 saw four similar, temporary rallies before a sustained recovery occurred.

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